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BEFORE THE U.S. HOUSE COMMITTEE ON AGRICULUTRE,
SUBCOMMITTEE ON GENERAL FARM COMMODITIES AND
RISK MANAGEMENT

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Mr. Chairman and members of the Committee, I appreciate the opportunity to appear at this hearing to discuss the current state of the U.S. farm economy, including the role of farm programs and the impacts of higher energy prices. After a very weak period at the start of this decade due to slow global economic growth and reduced U.S. exports, the U.S. farm economy began a recovery in 2003 that continues today and will remain strong into 2006. Strong global income growth and rising U.S. agricultural exports helped U.S. net cash farm income reach a record high in 2003, eclipse that record by 20 percent in 2004, and remain on track to approach the 2004 level again in 2005. The strong performance in farm cash flows, combined with lower interest rates, has up to this point offset higher energy prices and caused a surge in farm real estate values that has improved farm balance sheets.

While aggregate cash income remains healthy and farm equity is growing, there are a number of developments that will contribute to uneven economic performance for some producers and some regions. Principal crop prices have pulled back following last year's record-large harvests; however, price-based farm program payments are offsetting some of that decline. Meanwhile, livestock and livestock product prices remain robust.

Sharply higher energy prices are cutting into net farm income and will likely continue to affect production input and marketing costs in 2006. Losses caused by drought in the eastern Corn Belt and Hurricanes Katrina and Rita, as well as other regional adverse weather, have

reduced income prospects for some producers. Rising interest rates are also adding to farm production costs.

Global economic growth and rising U.S. agricultural exports will continue to underpin growth in the U.S. farm economy for many commodities. Macroeconomic uncertainties for 2006 include the effects of higher oil prices and rising interest rates as well as possible fluctuations in exchange rate changes. The U.S. dollar has trended down in recent years, and further depreciation would strengthen U.S. export prospects. USDA's late August forecast placed U.S. agricultural exports at $63.5 billion for Fiscal Year (FY) 2006, up $12.8 billion or 25 percent from FY 2000. This would be a record-high level of exports, even though Japan and several other countries remain closed to U.S. beef following the discovery of a cow with Bovine Spongiform Encephalopathy (BSE) in December 2003. U.S. beef and veal exports in FY 2006 are forecast to be only $0.8 billion, compared with $3.03 billion in FY 2003, the last full year of beef trade prior to the U.S. finding of BSE.

U.S. and World Economies Support U.S. Farm Economic Growth

The U.S. economy grew a very strong inflation-adjusted 4.2 percent in 2004, while the rest of the world also grew a strong 3.6 percent. For 2005, with the U.S. recovery maturing, interest rates rising, and oil prices strengthening, U.S. real economic growth (prior to Hurricane Katrina) was forecast at a reduced, but still-strong, 3.7 percent, with the rest of the world slowing somewhat to 2.8 percent, mainly due to weak performance in the European Union and Japan. Prospects for 2006 for the United States and the rest of the world are similar to 2005, although record high oil prices could reduce global growth.

The strong growth in foreign economies during 2004 came after several years of much lower growth. Lagging performance of Europe and Japan and slower growth in transition economies

and some other developing nations will slow foreign growth to just under 3 percent this year. However, Chinese growth is expected to continue to exceed 9 percent and economic prospects also appear good for Canada and Mexico, our two major trading partners.

Rising global incomes have been good for the demand for U.S. agricultural products here and abroad. Domestic spending on food, which also drives demand for animal feed, continues to be historically strong. Real personal consumption expenditures on food rose 5 percent in 2004, the largest annual increase since 1976, with spending for food away from home growing a little faster than for food consumed at home. This consumption spending growth compares with an average of 2.7 percent in 2003 and less than 2 percent during the economic slowdown in 2001 and 2002. Food consumption growth has exceeded 4.5 percent during the first half of 2005.

In addition to rising food demand, domestic industrial demand for farm products is also increasing, with ethanol production the most notable example. In 2005, U.S. ethanol production is forecast to be 4 billion gallons and account for 14 percent of corn use. The Energy Policy Act of 2005 requires that 7.5 billion gallons of renewable fuel be used by 2012. USDA's baseline projection prior to enactment was 4.7 billion gallons of ethanol production in 2012. Corn-based ethanol production of 7 billion gallons by 2012, compared with the baseline projection, would require the construction of the equivalent of nearly 40 new 60-million-gallon per year ethanol plants. Corn used in ethanol production would account for 21 percent of U.S. corn production. Currently rising ethanol prices and declining corn prices are strong incentives to expand ethanol production capacity.

The agricultural trade-weighted value of the dollar has depreciated 17 percent from early 2002 to this summer. Further declines are expected for the rest of 2005 and 2006 due to the historically large current account deficit. The declines are expected primarily against the

currencies of developing countries, notably Brazil, as the dollar has stabilized against the currencies of developed countries. The weaker dollar and improved foreign economic growth helped U.S. agricultural sales reach $62 billion in FY 2005 and the agricultural trade surplus attain $4.5 billion, well above the zero or negative balance initially expected by many analysts.

U.S. agricultural exports are forecast to rise to a record $63.5 billion in FY 2006. The primary factors leading to the forecasted rise include increased horticultural exports and larger cotton and soybean exports, particularly to China where record imports of these commodities are expected. This export forecast assumes, in part, that the markets that are now closed to U.S. beef exports because of BSE remain closed in 2006. This assumption simply reflects our standard forecasting procedure that assumes the current policies of foreign countries remain in place until they are explicitly changed. While beef and veal exports for FY 2005 are estimated at $0.8 billion, down from $3.0 billion in FY 2003, trade restrictions on U.S. beef created some additional export opportunities for other meats. U.S. pork exports have surged from $1.3 billion in FY 2003 to an estimated $2.3 billion in FY 2005, and poultry exports are up as well.

Outlook for Major Crops

During 2004/05, large global production for most crops exceeded consumption and led to rising inventories and reduced market prices compared with the prior year. For 2005/06, global production for major crops is expected to decline and fall short of consumption, thus reducing global carryover stocks. However, large crops are forecast for the United States, despite drought and Hurricanes, thus limiting U.S. inventory reductions and market price appreciation. Nevertheless, global grain stocks as a percent of total use remain low by historical standards, foreign economic growth appears sound, export prospects are good, farm programs are providing increased payments to program crop producers, and participation in crop insurance is high. In

addition, crop prices could move higher over the coming months after the harvest passes and logistical snags caused by Hurricanes Katrina and Rita are fixed.

In 2005/2006, global wheat, rice, coarse grain and cotton production are forecast to decline while global oilseed production remains about the same as in 2004/05. World wheat stocks at the end of the 2005/2006 marketing year are expected to decline 6 percent from a year earlier and global coarse grain stocks are expected to drop 14 percent, while world cotton and oilseed stocks remain stable, each rising about 1 percent.

For **wheat,** plantings for the 2005 crop declined by 1.6 million acres to 58.1 million, mainly due to 4 percent lower winter wheat plantings last fall. However, less abandoned acreage is expected, and harvested area and yields are expected to be very close to last year's levels. U.S. wheat production is estimated at 2.2 billion bushels, about the same as last year. Stable world imports but ample global supplies and increased exports from Russia, Ukraine, Kazakhstan and Canada are forecast to lower U.S. wheat exports by 88 million bushels in 2005/2006. With total U.S. use falling short of production, carryover stocks on June 1, 2006, are forecast to rise to 624 million bushels, up from 540 million this June 1. The farm price of wheat is forecast to average $3.00-$3.40 per bushel compared with last season's $3.40.

U.S. **rice** acreage is about the same in 2005 as in 2004, when producers responded to a strong recovery in prices and returns and boosted seedings. The second largest rice crop ever is expected, with modest Hurricane losses. Stocks ran up sharply last year but by the end of the 2005/06 marketing year are forecast at 34 million cwt, down from 38 million cwt at the start of this year, as domestic use and exports are both expected to improve. The U.S. farm price of rice is forecast to average $7.25-$7.55 per cwt this marketing year, compared with $7.33 per cwt in

2004/2005, as firm world prices are helping to maintain U.S. prices despite abundant U.S. rice supplies.

In 2004, the **corn** crop was a record 11.8 billion bushels as producers harvested a record 160.4 bushels per acre, exceeding the previous record set in 2003 by over 18 bushels per acre. The sharp increase in total supply led to a drop in U.S. farm prices for corn, from $2.42 per bushel for the 2003 crop to $2.06 for the 2004 crop. However, the huge increase in production offset the price decline, so the value of the crop—price times production—was the same in 2004 as in 2003, while government payments went up due to the reduced prices. For 2005/06, farmers planted 81.6 million acres to corn, up only 0.7 million, as increased fertilizer and fuel prices did lead producers to shift as much acreage from soybeans as expected. With drought in several Corn Belt States, U.S. corn production is forecast at 10.6 billion bushels, down 1.2 billion from last year but would still be the second largest crop ever, if realized. Total corn use is again expected to be strong as exports and ethanol use rise. Use is expected to about match this year's production, leaving carryover stocks for 2005/06 about the same this marketing year as last with farm prices averaging $1.70-$2.10 per bushel.

Early-season prices have been weak due to the slowdown in Gulf exports, high barge and rail rates, and limited barge capacity. USDA is allowing emergency and temporary storage to be used for grain pledged as collateral for Commodity Credit Corporation (CCC) price support loans; assisting with the movement of barges of damaged corn from New Orleans; encouraging alternative shipping patterns; and allowing producers to store USDA-owned corn on the farm with the option to purchase to help relieve the pressure on the grain storage and transportation systems until the Katrina-caused logistical problems are fully worked out.

Soybean production reached a record 3.1 billion bushels in 2004, contributing to higher domestic use, exports, and carryover stocks. A sharp decline in Brazil's crop to 51 million tons due to drought and Asian rust contributed to the U.S. export strength. In 2005, farmers planted 73.1 million acres, down from 75.2 million in 2004. The declines were largest in the south, where Asian rust was a factor and in the northern plains, where there was shifting to other oilseeds. USDA's September crop production survey estimated soybean yields down 7 percent from last year's strong outturn but still 17 percent above 2003. Soybean production is estimated to be 2.9 billion bushels in 2005, compared with 3.1 billion last year. Strong demand for U.S. soybeans is expected this year. The U.S. has ample supplies, prices are competitive, and Brazil appears to be curbing its production expansion. USDA estimates that Brazil will reduce soybean acreage for the first time in 7 years. Strong appreciation of the Brazilian currency, low internal soybean prices, high transportation costs and poor yields last year caused a sharp drop in profitability, which is expected to be repeated this year. With U.S. total use of soybeans expected to exceed production, carryover stocks are forecast to decline to 205 million bushels from 295 million at the start of the year. Prices in 2005/2006 are forecast in a range of $5.15-$6.05 per bushel compared with $5.75 in 2004/05.

In 2004, U.S. **cotton** production reached a record 23.3 million bales, up from 18.3 million in 2003**.** Despite record-high exports of 14.3 million bales, the record-large crop increased carryover stocks and pulled prices down some 30 percent. For 2005, production was estimated post-Katrina at 22.3 million bales, the second highest ever. Loss estimates due to Hurricane Rita are not yet know but do not appear to be enough to change the overall supply/demand picture for 2005/06. Although domestic use is expected to continue its trend decline under pressure from imported textiles and apparel now that textile and apparel import quotas have been eliminated,

export prospects are excellent. Reduced production in China and strong growth in demand globally for cotton is expected to boost U.S. cotton exports to a new record, in excess of 15 million bales. Even so, the prospective crop is so large it is likely to exceed use and raise carryover stocks to 7 million bales from 5.75 million this year.

Under the 2002 Farm Bill, lower prices for major crops trigger increases in counter-cyclical payments and marketing assistance loan benefits. Based on current market price projections, counter-cyclical payments could reach nearly $6 billion for the 2005/06 crops, up from about $4.3 billion for the 2004/05 crops and $0.5 billion for the 2003/04 crops. Marketing assistance loan benefits (loan deficiency payments, marketing loan gains and certificate exchange gains) are projected to increase from less than $1 billion for the 2003/04 crops to $5.3 billion for the 2004/05 crops to about $6.5 billion for the 2005/06 crops.

Horticultural markets continue to become an increasing contributor to U.S. farm income. For 2005, cash receipts from fruits, vegetables, and greenhouse and nursery crops are forecast to be $50.1 billion, up nearly $2 billion from last year. Greenhouse and nursery products are expected to see the largest gain, although Hurricane Katrina is estimated to have caused serious damage to Florida's nursery industry. Exports for horticultural crops for FY 2006 are forecast to reach $15.9 billion, up substantially from $14.5 billion last year.

In recent years, strong demand for imported products has increased the U.S. horticultural trade deficit which is forecast at $12.2 billion in FY 2006, up from $11.1 billion in FY 2005. During the past decade, domestic production of fruits and vegetables has averaged 0.5 percent annually, compared with import growth of 4.4 percent. Increasing U.S. consumer preferences for fruits and vegetables combined with rising affluence and demand for food diversity are likely to maintain the import growth.

Sugar production for 2005/06 is expected to be about the same as last year, based on the post-Katrina crop production survey. Some 20 percent of sugarcane acreage in Louisiana was subjected to hurricane force winds from Hurricane Rita, so a further modest reduction in production is possible. Based on the currently announced domestic and import quotas, carryover stocks are expected to be less than 10 percent of use for 2005/06, an unusually low level.

Outlook for Livestock, Poultry, and Dairy

Despite increasing meat and milk production in 2005, livestock and livestock product producers have continued to see a continuation of 2004's good financial returns. Meat and poultry production is expected to be up 2.5 percent in 2005 after little change in 2004. Consumer demand for meat and dairy products has been strong this year, and farm prices have been a record or near-record high. A 2.9-percent increase in total meat and poultry production is expected in 2006, leading to a softer market.

Beef production is expected to be up 1.9 percent in 2005. The increase reflects the end of several years of herd liquidation and lower cattle inventories. In addition, the resumption of imports of Canadian cattle under 30 months of age is augmenting tight supplies of slaughter-ready U.S. cattle. About 650,000 head are expected to be imported during 2005. Between July 18 and September 10, 2005, 119,156 head had been imported. Strong consumer demand for meat protein continues. Normally, the third quarter of the year is seasonally weak, but this year, even with resumption of Canadian live cattle trade, thus far cattle prices have declined less than expected and feeder cattle prices have been very strong. During 2004, the price of choice steers averaged a record $84.75 per cwt, and USDA forecasts prices that will average a new record of $85 per cwt in 2005. For 2006, as the U.S. cattle inventory continues to rise and Canadian cattle are imported for a full year, U.S. beef production is expected to rise 3.8 percent and Choice steer

prices average between $76 and $82 per cwt. Prices could be substantially stronger if Japan and other Asian countries open their markets to U.S. beef.

In 2005, **pork** production is forecast to rise only 1.3 percent despite strong hog prices in 2004 and 2005. The price of slaughter hogs averaged $52.51 per cwt in 2004, up from $39.45 in 2003, as tight supplies of beef boosted the demand for pork. In addition, United States pork exports were a record high in 2004 as demand has been strong in markets that banned beef imports from the U.S. For 2005, hog prices are forecast to average $48.50 per cwt. Hog producers have been cautious about expanding, as indicated in farrowing intentions surveys. Pork production in 2006 is expected to increase 1.6 percent, with hog prices forecast to average $43-$47 per cwt.

Broiler production is expected to increase 4 percent to a record 35.4 billion pounds in 2005. Higher prices for competing meat products and an improving domestic economy pushed whole-bird broiler prices to a record high in 2004. Continued strong prices for competing meats and a rebound in U.S. broiler exports have helped maintain broiler prices this year only slightly below last year's levels. Exports are expected to be up 12 percent in 2005 after Avian Influenza problems closed some U.S. export markets in 2004. For 2006, broiler production is projected to rise 3.1 percent and prices remain strong at 70 to 76 cents per pound, compared with 72.5 cents this year.

In 2005, **milk** production is expected to increase by 3.2 percent, after remaining flat in 2004. In 2003 and 2004, milk production had the slowest growth over a 2-year period since the mid-1980s. Weak milk prices, poor forage quality, suspension of imports of dairy cows and heifers from Canada, and limitations on the availability of bovine somatotropin (rBST) were factors. Tight milk supplies caused the all-milk price to average a record $16.13 per cwt in 2004, up from $12.55 per cwt in 2003. For 2005, the all-milk price is forecast to average $15.15 per cwt.

USDA's large purchases of nonfat dry milk finally came to an end in late 2004, and tight domestic and international milk supplies are keeping the price of nonfat dry milk above the CCC purchase price. In 2006, milk production is forecast to increase 2.3 percent as output per cow continues to recover, the normal rBST supply resumes, and lower feed costs boost milk output. The all-milk price is projected to average $13.10-$14.10 per cwt in 2005, down about 10 percent.

Higher milk prices in FY 2004 reduced payments under the Milk Income Loss Contract (MILC) program. The MILC payment rate averaged $0.22 per cwt in FY 2004 with payments being triggered during January through April. In FY 2005, MILC payments were made only in June and averaged less than $0.01 per cwt.

Outlook for Farm Income

In 2004, farm cash receipts, net farm income, and net cash farm income all registered historic highs. Farm cash receipts reached a record $241 billion as both livestock and crop receipts were record highs. Livestock receipts rose by $18 billion in 2004, reflecting strong prices for cattle, hogs, poultry, and milk. Prices for major crops were generally strong in the early part of 2004, allowing producers to sell the remainder of the large harvests from the fall of 2003 at favorable prices. These higher prices were largely responsible for a $7-billion increase in crop receipts in 2004. Net cash farm income reached a record $85.5 billion in 2004, up from the previous record of $71.6 billion in 2003.

In 2005, USDA released income estimates at the end of August, which did not take into account any losses or production cost increases attributable to Hurricane Katrina. Crop receipts are forecast to decline slightly from last year's record high, while livestock receipts remain about the same. Farm cash receipts in 2005 are projected to be the second highest on record, at nearly $240 billion. Higher government payments are forecast to offset the slight drop in crop cash

receipts and cash production costs that are expected to be $8 billion higher in 2005 compared with 2004. The record crops harvested in 2004 lowered prices for major crops, triggering additional government payments under the 2002 Farm Bill. With strong receipts and higher government payments, the late-August forecast of this year's net cash farm income was $85.2 billion, very near last year's record. Most producers will face generally favorable conditions, although some, such as those affected by adverse weather, will not see these income benefits.

In 2005, government payments were forecast in late August to reach $21.4 billion, up from $13.3 billion last year but below the record of $22.9 billion in 2000. Lower prices for major crops are expected to increase counter-cyclical payments marketing assistance loan benefits in 2005. Ad hoc disaster payments are forecast to increase from $0.6 billion in 2004 to $3.9 billion in 2005. The increase in disaster payments reflects legislation passed by Congress in 2004 authorizing payments to producers affected by adverse weather in either 2003 or 2004. These payments were disbursed earlier this year. Tobacco producers are also forecast to receive about $1 billion under the Tobacco Transition Payment Program (TTPP) this year, which provides tobacco quota holders and producers of quota tobacco payments for the termination of the tobacco marketing quota and price support loan programs. These payments are financed through assessments on manufacturers and importers of all tobacco products.

A useful indicator of producer returns from the market is net cash farm income excluding government payments. In 2000, net cash farm income excluding government payments hit a cyclical low of $34 billion. As markets have strengthened, net cash income from the market more than doubled to $72.2 billion in 2004. In 2005, net cash farm income excluding government payments is projected to fall to $63.8 billion. While below this past year, net cash farm income excluding government payments remains well above the cyclical low in 2000.

Based on August conditions, farm cash production expenses were expected to increase about $8 billion or 4 percent in 2005, following an increase of $8.3 billion, or 5 percent last year. Higher prices for feed, feeder livestock, labor, fuel, fertilizer, and other inputs pushed up production expenses in 2004. In 2005, feed prices are down but energy-based input costs and interest expenses are up.

The income earned by farm operator households in 2005 is expected to continue the increases of recent years. Average farm operator household income is forecast at $88,105, up slightly from 2004, but 2004 household income was 27 percent above 2003. A 4.3-percent increase is expected in off-farm income in 2005, which will more than offset an expected reduction in household earning from farm operations.

With another sound income year expected, farmland values may rise 7 to 8 percent in 2005. This increase would continue the reductions in farm-debt-to-asset ratios seen in recent years. After ranging between 14.8 percent and 15.2 percent during 1992-2002, the farm debt-to-asset ratio fell to 14.4 percent last year, and a further drop to 13.4 percent is expected this year. In 2004, U.S. farm real estate rose a very sharp 11 percent, and with another strong rise expected this year, the degree of farmland leverage continues to decline, giving farmland owners a measure of equity protection should the agricultural economy weaken.

Perspectives on Energy-price Developments and the Farm Economy

Producers use energy directly for operating machinery and equipment on the farm and indirectly in fertilizer produced off the farm. While both U.S. agriculture and the fertilizer industries have made significant improvements in energy efficiency over time, energy-related expenditures make up an important share of total production expenses. Farm expenditures on energy-related production inputs—electricity, fuels and oils, and fertilizers—rose from about 5

percent of total farm cash expenses in 1910 to over 17 percent of total farm cash expenses in the early 1980s. Since the early 1980s, improvements in efficiency and relatively stable energy prices caused energy-related expenses as a share of total farm cash expenses to fall to about 11 percent by 1999. Since then, increasing energy prices have caused the share of energy-related expenses to start rising again. USDA's August forecasts have energy-related expenses accounting for 13 percent of total farm cash expenses in 2005, up from 12 percent in 2004, as expenses for energy-related production inputs increase $3.3 billion, with fuels and oils accounting for $2 billion and fertilizers $1.3 billion. Energy price increases following Hurricanes Katrina and Rita could add $1.5 billion to these 2005 expense forecasts.

USDA's Economic Research Service (ERS) cost of production estimates provide insights into which sectors of the agricultural economy are most reliant on energy, and, therefore may be most affected by changes in energy prices. Using data collected in the Agricultural Resource Management Survey (ARMS), ERS estimates the cost of production for corn, soybeans, wheat, cotton, grain sorghum, rice, peanuts, oats, barley, sugar beets, tobacco, milk, hogs, and cow-calf operations based on surveys conducted every 3-8 years.

These estimates indicate that commodities with the highest energy-related expenses per acre include tobacco, rice, sugar beets, and peanuts. For example, in 2003, the average energy-related expenses for tobacco were about $400 per acre, with about $100 per acre for fuels, lubricants, and electricity and about $300 per acre for fertilizer and soil conditioners. In comparison, the average energy-related expenses for rice, sugar beets, and peanuts were about $128, $108, and $97 per acre, respectively. Energy-related costs for corn, sorghum, and wheat averaged $66, $51, and $34 per acre, respectively. On the lower end, energy-related costs for soybeans were only $16 per acre because of significantly lower fertilizer use.

To better gauge how per acre energy costs may affect commodity producers, these energy expenses can be expressed as a percent of per acre total farm expenses. Based on 2003 estimates, energy-related costs as a percent of per acre total farm expenses, which includes land and depreciation, are the highest for sorghum, 23 percent; rice, 21 percent; corn, 19 percent; and wheat, 18 percent.

USDA data for 2004 shows production expenses by farmers by region and farm size. For example, energy-related expenses as a share of total farm production expenses were highest in the Midwest, where energy-related expenses accounted for about 11 percent of total farm production expenses, followed by the South and Plains regions at 10 percent, and then the Atlantic and West regions at about 7 percent.

In terms of farm size, larger farming operations incur more expenses in general than smaller farming operations, thus their spending on energy-related inputs is greater than for smaller operations. For 2004, farm operations selling $1 million or more annually of farm products averaged about $144,000 in energy-related expenses, with $63,000 for fuels and $81,000 for fertilizers. In comparison, operations in the $100,000 to $250,000 sales class spent an average of $22,000 in energy-related expenses, with $8,000 for fuels and $14,000 for fertilizers. However, energy-related expenses averaged about 6 percent of total farm production expenses for farmers selling $1 million or more yearly but about 12 percent of total farm production expenses for farmers in the $100,000 to $250,000 sales class.

Natural gas is the primary input in the production of nitrogen fertilizer, representing 70 to 90 percent of the cost of anhydrous ammonia nitrogen fertilizer. When U.S. natural gas prices started to increase significantly in 2000, the cost of domestically produced ammonia also rose

significantly. Average U.S. ammonia production costs doubled from 1999 to 2003, the latest year for which we have data.

These rising production costs have been reflected in the prices paid by farmers for fertilizers. From 1999 to 2004, prices paid index for fertilizer rose by 34 percent. The U.S. Department of Energy's Energy Information Administration (EIA) reports that the U.S. average natural gas price for industrial users doubled over the same period. The price paid index for fertilizer for August 2005 rose 0.6 percent from July and was 13 percent above August 2004, reflecting, in part, the increase in natural gas prices from 2004 to 2005.

Long-term increases in natural gas prices will lead to an increase in the cost of U.S. nitrogen fertilizer production and higher expenses for fertilizers. Increasing imports of fertilizer will limit the impact of higher domestic natural gas prices on farmers to the extent that natural gas prices in other countries do not increase as rapidly as prices in the United States.

In the short run, farmers are limited in what they can do to mitigate the effects of higher energy prices. Some producers may be able to shift to alternative crops, reduce field operations by switching from conventional tillage practices to reduced till, or allow crops to dry naturally.

Over the long term, farmers have more flexibility and can acquire energy efficient equipment, which occurred following the energy price hikes in the 1970s and early 1980s. Advanced technologies and farming practices can be adopted, including precision farming, which involves yield monitoring and calibrated application of pesticides and fertilizers.

The spike in energy costs in recent years has raised questions about the effect of higher energy costs on retail food prices. Because energy and energy-related costs represent a relatively small share of the retail cost of food, we expect that higher energy prices to have only a small effect on food prices.

ERS estimates of consumer spending on food indicate that the farm value represents about 19 percent of the retail cost of food with the remaining 81 percent attributable to food processing, transportation, wholesaling, and retailing. The energy component of the marketing bill for food was estimated to account for 3.5 percent of retail food expenditures in 2000, with eating places incurring nearly 40 percent of the fuel and electricity costs of food marketing. The rail and transportation costs accounted for another 4 percent of food marketing costs, but only a portion of those expenses are energy-related costs.

Energy and energy-related costs are important in agricultural production and higher prices for these production items have increased farm production expenses. Despite the increase in production costs, net cash farm income has continued to rise as cash receipts have stayed strong. Although higher energy costs will surely be a financial problem for some producers this and next year, as long as cash receipts remain strong the farm economy is likely to absorb these costs without crisis. We will continue to monitor the energy price situation closely.

While uncertainty remains over the sustainability of the global economic recovery, rising interest rates, the value of the dollar, issues raised by the Federal budget deficit, trade negotiations, emerging competitors, animal diseases, and oil prices, U.S. agriculture appears strong enough to deal with the uncertainties ahead.

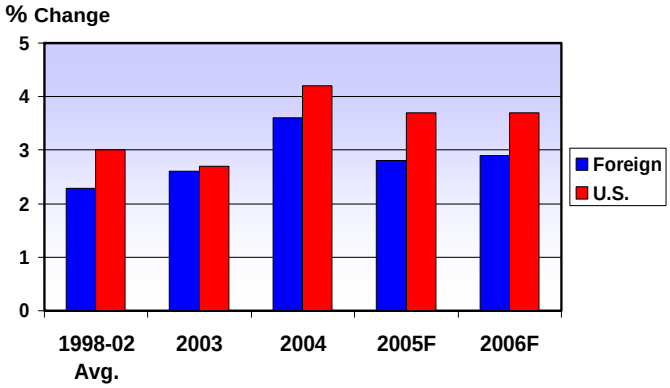
That completes my statement, and I will be happy to respond to any questions.

Farm Economic Indicators

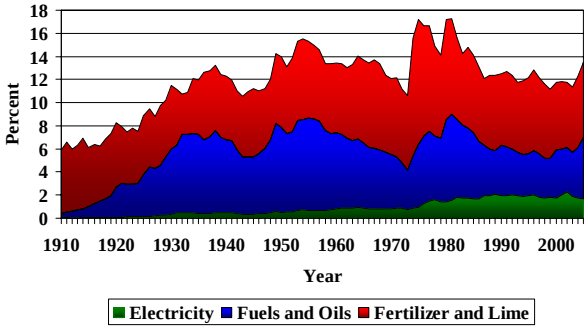
Commodity Prices	Unit	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05E	2005/06F
Wheat	$/bu	2.48	2.62	2.78	3.56	3.40	3.40	3.00-3.40
Corn	$/bu	1.82	1.85	1.97	2.32	2.42	2.06	1.70-2.10
Soybeans	$/bu	4.63	4.54	4.38	5.53	7.34	5.75	5.15-6.05
Rice	$/cwt	5.93	5.61	4.25	4.49	8.08	7.33	7.25-7.55
Upland cotton	cents/lb	45.00	49.8	29.8	44.5	61.8	42.9	NA
		2000	2001	2002	2003	2004	2005F	2006F
Hogs	$/cwt	44.70	45.81	34.92	39.45	52.51	48-49	43-47
Steers	$/cwt	69.65	72.71	67.04	84.69	84.75	84-86	76-82
Broilers	cents/lb	56.20	59.10	55.60	62.00	74.10	72-73	70-76
Milk	$/cwt	12.40	15.04	12.18	12.55	16.13	15.15	13.10-14.10
Gasoline, all grades 1/	$/gallon	1.53	1.47	1.39	1.60	1.89	2.37	2.45
Diesel 1/	$/gallon	1.49	1.40	1.32	1.50	1.81	2.41	2.50
Natural gas (wlhd) 1/	$/K cu. ft.	3.70	4.01	2.95	4.89	5.50	7.81	7.64
Electricity 1/	$/kwh	8.24	8.62	8.46	8.70	8.92	9.22	9.37
Ag. Trade (Bil. $)	FY99	FY00	FY01	FY02	FY03	FY04	FY05F	FY06F
Total exports	49.1	50.7	52.7	53.3	56.0	62.4	62.0	63.5
Asia	18.4	19.6	20.1	19.5	21.7	24.3	22.4	NA
Canada	6.9	7.5	8.0	8.6	9.1	9.6	10.4	NA
Mexico	5.7	6.3	7.3	7.1	7.6	8.4	9.0	NA
Total imports	37.3	38.9	39.0	41.0	45.7	52.7	57.5	61.0
Farm Income (Bil. $)	1999	2000	2001	2002	2003	2004	2005F	2006F
Cash receipts	187.8	192.1	200.1	195.0	216.6	241.2	239.6	NA
Gov't payments	21.5	22.9	20.7	11.2	17.2	13.3	21.4	NA
Gross cash income	224.2	228.7	235.6	221.0	249.5	271.7	279.3	NA
Cash expenses	166.3	171.8	175.5	171.6	177.9	186.2	194.0	NA
Net cash income	58.0	57.0	60.1	49.5	71.6	85.5	85.2	NA

E=estimate; F=forecast.
1/ Source: Energy Information Administration, Short Term Energy Outlook, September 7, 2005.

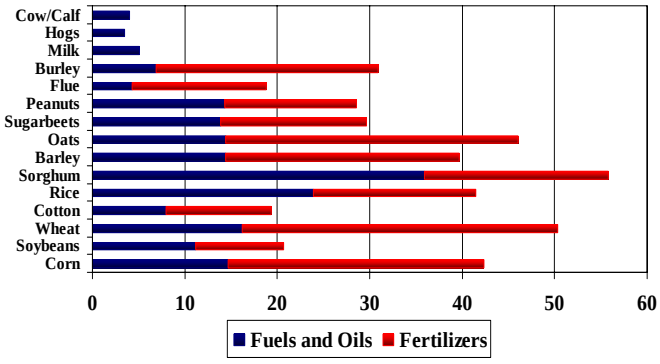
U.S. & Foreign GDP Growth Rates



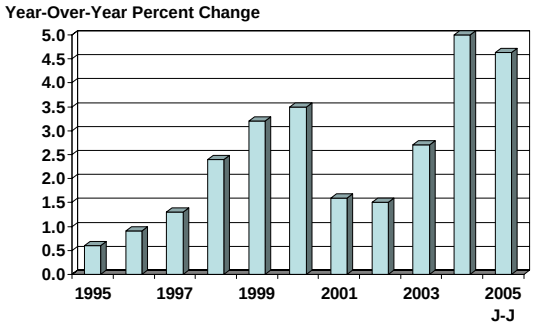
Energy Related Expenses as a Share of Total Cash Expenses



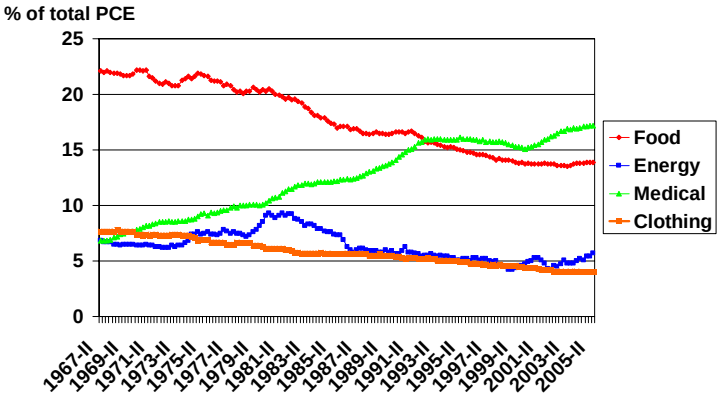
Energy Related Expenses as a Share of Total Operating Costs, 2003



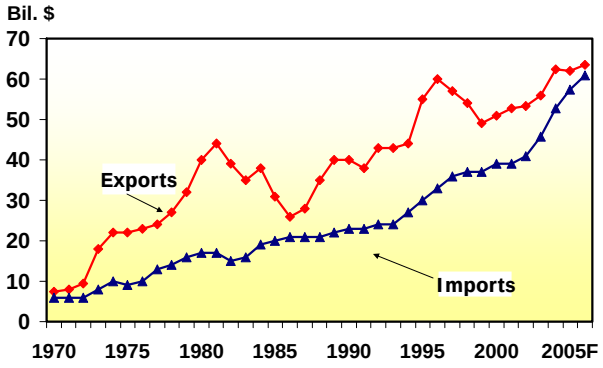
Real Personal Consumption Expenditures for Food



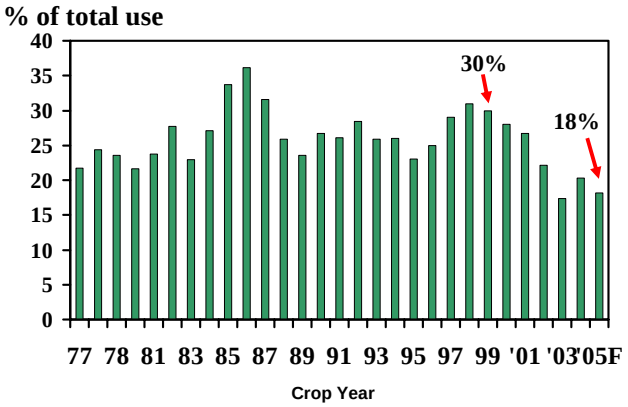
Personal Consumption Expenditures Shares, by Quarter, 1995-2005



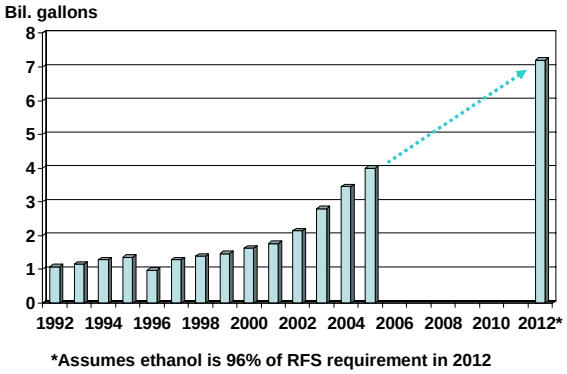
U.S. Agricultural Exports & Imports



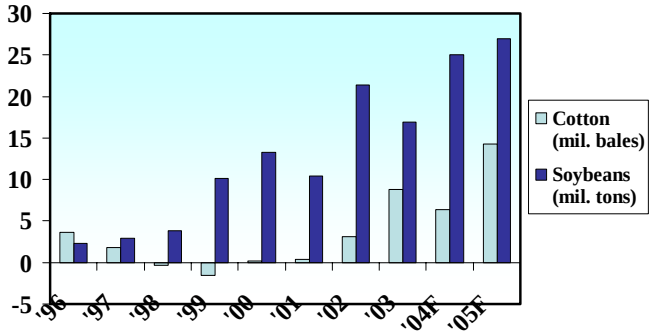
World Wheat and Coarse Grain Stocks



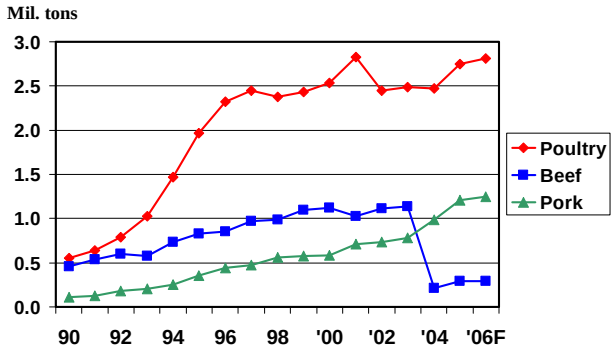
Ethanol Production



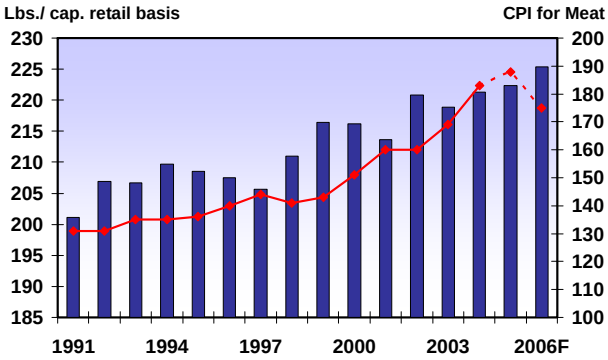
China Imports of Cotton and Soybeans



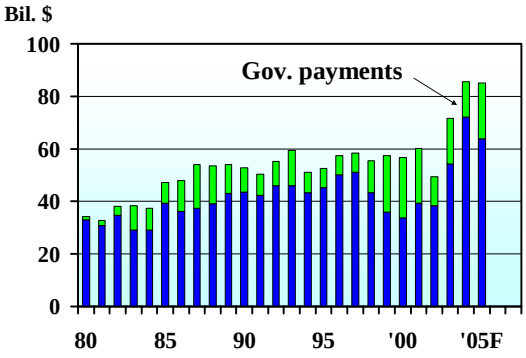
U.S. Meat Exports



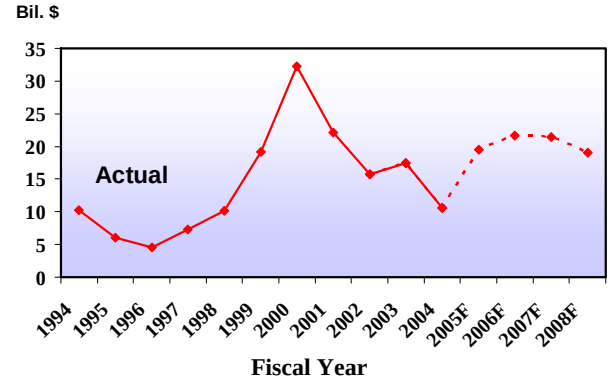
Retail Meat Consumption & CPI for Meat (red line)



U.S. Net Cash Farm Income



CCC Farm Program Net Expenditures



Value of Farm Real Estate (Jan. 1)